Europe's dilemma: austerity revisited or a new path for sustainable growth

High-level conference on alternatives to the current management of the Euro crisis

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Galbraith: The spirit of dignity in Athens is worth more than money

The European establishment reacted with shock and horror after the Greek elections in January swept Syriza to power, but the new government offers a rare hope of recovery, economist James Galbraith told the ETUI conference on alternative approaches to the euro crisis. “There is a spirit of dignity in Athens that is worth a great deal more than money. And that is a spirit which is contagious, and may be felt in Spain, Portugal, and Ireland,” he said.

Galbraith, a professor at the University of Texas at Austin, is the author most recently of, *The End of Normal: The Great Crisis and the Future of Growth*. He is also a friend, co-author and former colleague of the Greek Finance Minister Yanis Varoufakis and is an informal economic advisor to the government.

The economist was speaking from his close vantage point in recent dramas in both Brussels and Athens, as he accompanied Varoufakis in his early attempts to get to grips with various looming euro demands. And he put the Greek experience into a wider European perspective, as a potential game-changer in the management of the crisis. “Clearly something is happening in Europe. But what?” he asked.

What was at stake in Greece went far beyond merely financial questions, Galbraith said. “It goes beyond the fate of a small and historically very badly governed country, with weak institutions, that has suffered abominably in the wake of the crisis over the past five years, losing 25% of its output, having unemployment rates comparable to those of the United States during the worst period of the Great Depression, exceeding well over 50% for the youthful population, and facing severe stresses in every aspect of public and social life,” he said. “It goes even beyond the grave situation that is visible in every street in Athens, to the future of Europe. And beyond that to the meaning of democracy in our time.”
Astounding achievement

He described as “astounding” what the Greeks had achieved since the January 25 election. “They have dismantled, I think definitively, and banished an entire previous political class. They have ended a rotten and corrupt two-party duopoly, and they have installed a government of dissidents, activists and professors. Including, of course, the finance minister, who was for years banned and blacklisted from Greek television by the authorities,” he said.

Galbraith underlined that the Greek people did this, “In the face of a wall of resistance from their own media, which continues, and in the face of a wall of incredulity from the European partners, which also continues.”

For a historical perspective, Galbraith said that there was possibly nothing comparable in Europe since the election of Solidarity in Poland at the end of the 1980s. “And it is obvious that it has had a galvanising effect on the political atmosphere outside of Greece and around Europe, spreading an aspect of possibility that was not there before, opening up a window of opportunity,” he said.

But at the same time, the new government faces an elaborate, well laid political and economic trap, Galbraith warned. This minefield is, “entirely of human construction, purely artificial: with deadlines, deadlines for reviews, deadlines for payments, payment schedules,” he said. “It was imposed before the January 25 election, and is comprised also of caps on liquidity assistance to banks, issuance of treasury bills, the inability to discount treasury bills at the European Central Bank, which came into play after the election.”

And yet, these obstacles are from a macroeconomic and psychological standpoint counter-productive, Galbraith said. “Neither the government nor the Greek people have shown any inclination to bow.”
Manoeuvring the minefield

Nonetheless, manoeuvres of a fairly high order are needed to get through the minefield, Galbraith explained. “The first stage was to establish that the principle that the memorandum of understanding, which had subjected Greece to a form of colonial governance, according to which practically everything the government did was dictated from outside and written in English, was a thing of the past, rejected in an open and decisive election,” he said.

In principle, that proposition was agreed to after some rancorous negotiations that led to the communiqué of February 20. It was, Galbraith said, “A major step forward, but one that came at the cost of deferring certain measures in the Syriza election platform – like the rise in the minimum wage, reversing privatisations and limiting or accepting a primary surplus target.”

The second stage, still ongoing, involves implementing these changes at an operational level, including establishing a professional, acceptable working relationship with the international teams, which Galbraith accepted have a legitimate role. “That has required an adjustment on the part of the international teams, who came back to Athens thinking they could conduct business under the same operational rules. They found that they could not continue as before,” he said.

The third stage in this process, Galbraith said, which has to be resolved at a political level, is to restore Greece’s liquidity and enough financial stability for the banking system so that economic activity can resume. He described this as a major problem in the last two months, given the atmosphere of fear that surrounded the election and the uncertainty that succeeded it, with banks suspending some of their activity and capital taking flight.

“A decision to move past destabilisation had to be taken at a political level - and it is possible that that has been accomplished at least in part last night,” he said, referring to the EU summit in Brussels on March 19 and 20. Galbraith offered rare praise for German Chancellor Angela Merkel for taking a “pragmatic step that may well mark the turning of the corner and easing of the pressures.”
These steps all point in the direction of stability and an alternative to the austerity narrative, Galbraith said. “As these manoeuvres mature, there is the prospect of a politically stable government in Europe led by forceful personalities presiding over an economy that is so far down that it has no place to go but up,” he said. “This is in the wake of a crisis brought on by the neo-liberal policies of the 2000s and then aggravated and prolonged by the austerity ideology that succeeded the policies, a profoundly counter-productive policy with which Europe has reacted to the crisis.”

**Political character assassination**

Indeed, Galbraith said the prospect that an anti-austerity government might mean the beginning of recovery “is a nightmare in certain quarters. It is the worst thing that could happen if you are associated with the larger political system.”

The many who are associated with the establishment doctrine have thrown down a line of mines and barriers, he said: “It is a campaign of political character assassination, which has been aimed specifically at one pillar of the potential Greek revival, and that is my friend, the finance minister Yanis Varoufakis.”

Galbraith said this political character assassination was a familiar political game in the United States, where it had been aimed at presidential hopeful Gary Hart and Presidents Bill Clinton and Barack Obama. He said these attacks were characterised by “a concept of freedom of the press that applies most to those who own them.”

Nonetheless, Galbraith was confident that Syriza would prevail. “This will, I think, pass, because the other leader of the Greek government is the real thing,” he said. “I have met a lot of political leaders in my time and I have not known anyone who approaches Alexis Tsipras in the way he can assess the political situation with a very cool eye. Which is why he came from nowhere to become prime minister.”
In Greece, he said the new administration had already won over voters. “The Greek people elected their government in complete defiance of their own media,” he said. “And they have rallied behind it, by margins of 80%, which means half of those who voted against them in the election have come to support them.”

**Coherent narrative?**

During the question and answer session afterwards, Galbraith elaborated on the unique challenges facing the new government. “The first month has been taken up by crisis management and the enormous amount of time-wasting that goes on in European governance, with ministers spending many hours on airplanes travelling to meetings and many hours in meetings dealing with problems that could easily be handled by staff,” he said, underlining how this has affected the government’s ability to present a coherent narrative.

He noted that the finance ministry “was completely cleaned out” when Varoufakis walked in, with no computers or documents in place. “Building capacity takes time,” he said. But the government came quite quickly to an understanding of what its key points of departure from the memorandum of understanding were, some of which he accepted as reasonable. “So you collect taxes and go after tax evaders, which is not in conflict with the wording of previous memorandums. You need a reform of government institutions,” he said.

Some things had to change, he said. “There was a completely unrealistic 4.5% primary surplus target, justified on the grounds that under completely different circumstances, Belgium had achieved it in the 1990s. There was a privatisation programme set up with a debt collection mentality, with assets sold at fire-sale prices and no consideration of whether it was economically sensible to sell them,” he added.

Responding to a question on collective bargaining, he said that under the previous government, this was reduced to nothing and the objective of the current government was to restore it. “That is a condition over which there was some initial conflict, but the government is not going to backtrack on this.”
And from an economic point of view, that is the right thing to do. This is not something they are doing in defiance of appropriate economic strategy, but part of proper economic strategy,” he said.

**The changing euro rulebook**

Galbraith challenged the notion that the new government was breaking any euro rules, noting that the rulebook seemed to change over time and according to circumstances. He noted that on February 4, the European Central Bank revoked the waiver permitting Greek banks to discount Greek government debt. “They said they would restore it when there is an agreement. There was an agreement on February 20 and it is now March 20 and that waiver has not been restored. The actions of the ECB are different for governments of different political persuasions,” he said.

On whether Greece might exit the euro, Galbraith said, “it would be a novelty and fraught with all kinds of perils.” But he underlined that it would be a step, “taken on the option of the European authorities if they choose to wreck the eurozone, but not something the Greek government will take alone.”

Galbraith could not say if Grexit would destroy the euro, noting that there were many who thought they could ring-fence it. “But then the Soviets thought the departure of the Baltics could be ring-fenced, and the Yugoslavs thought the departure of Slovenia could be ring-fenced, and there were people who thought in 1860 that the departure of South Carolina would not lead to the breakup of the country, but they were wrong about that,” he said. “South Carolina was described at the time as, ‘too small for a republic, too large for an insane asylum’ and something of the same mentality surrounds these discussions. One does not take these steps without thinking very carefully.”

Yet Galbraith remained optimistic that Greece could spur change across Europe. “One thing leads to another. So if the survival of an alternative model in Greece leads to something in Spain, who knows where it could lead?” he said. “Since one could not have anticipated an 80% approval rating for a Syriza government in Greece six months ago, it would be bold to dismiss the
possibility of change in the political climate elsewhere in Europe.” And then he closed with the words of French writer Emile Zola: “La vérité est en marche et rien ne l’arrêtera.”

**Flassbeck: We need to talk about wages**

The euro crisis has been mishandled in many ways, but perhaps the least understood aspect has been the role wages play, according to German economist **Heiner Flassbeck**.

Flassbeck, a former State Secretary in the German Federal Finance Ministry in the late 1990s, when the euro was created, said the single currency’s fixation with inflation led to labour cost disparities. But he warned that cutting wages would be the worst response in most countries.

Flassbeck is the author of *Against The Troika: Crisis and Austerity in the Eurozone*, co-written with Costas Lapavitsas. He is also a former director at the United Nations Conference on Trade and Development (UNCTAD), and lead author of UNCTAD’s influential Trade and Development Report.

Talking about the broader European picture, he condemned the recent prescriptions to raise the retirement age, increase working hours and remove the social fabric of countries to move to a more Germanic framework. “That’s nonsense. It was plain nonsense from the very beginning, but it is still there,” he said, dismissing the note produced by ECB President Mario Draghi and European Commission President Jean-Claude Juncker for the EU summit in February as one that offered “no future.”

While Flassbeck said monetary union was “an absolutely reasonably target as most countries had already fixed their currencies to the Deutschmark,” he also noted that it led to “some countries living beyond their means and some living below their means.” This was because monetary union was at its heart an agreement about a common inflation target rather than a union of harmonised public budget targets.
But the euro then led to divergences in inflation. “One country was much lower than the 2% inflation target, and that was Germany. Germany was living dramatically below its means, violating the spirit and the rules of monetary union,” he said.

How Germany drove the euro apart

How did it happen? Flassbeck explained that Germany at that time tried to bring unemployment down by reducing wages. But the small annual divergences in wages yielded a huge gap over time. The result, he said, was there was now a 20% wage disparity gap between Germany and France. “Italy and France cannot survive with a gap of competitiveness with Germany because they are losing export shares every day. If this gap remains, then monetary union cannot continue,” he said.

Policy makers in France and elsewhere might be tempted to respond to this emerging gap by cutting wages, but Flassbeck was firmly against such a move. “Even if they did it, it would be silly and foolish as it would destroy the rest of the French economy,” he said. “That is what is happening in Greece. The wage cutting is much worse than the austerity because this brought a dramatic drop in income and this dramatic drop in income led to a rise in unemployment.”

Flassbeck was adamant that cutting wages increased unemployment. “The labour market is not a potato market,” he said. “But everyone is treating the labour market like a potato market. And as long as we do that, we will never get out of the crisis. Because we need the income of average people to grow. You need an expectation from the average people on the street that their income will grow by 2% or 3% next year. And if you drive that out of the system, then you have killed growth.”

Politically, there are consequences too, Flassbeck said. “If they cut wages in France, it will be disastrous: then Marine Le Pen will definitely become president,” he said, before pointing out, ominously, “If they don’t cut wages, it will be two years longer.”
So what is the alternative? He urged European policy makers to abandon austerity. “We don’t just need the end of austerity, we need stimulation. We need dramatically quick stimulation,” he said. “Everywhere, income expectations are dramatically depressed and monetary policy has run out of instruments. It can be only be government that changes course. We have to turn around. This is the only way to escape deflation. And only if Germany is the front runner.”

Flassbeck called for a U-turn in economic policy and economic thinking. “We have a window of opportunity to change the course of European monetary union,” he said. “It’s highly improbable in my view that we will turn around. Why? What we see in Greece seems to be progress. The memorandum of understanding is now a memorandum of misunderstanding. But other countries are still under the same pressures as before.”

We make them debtors and then tell them not to be debtors

In the question and answer session that followed, Flassbeck said collective bargaining could do a lot to keep wages from falling too fast, but noted that the institution for such negotiations, the macro-economic dialogue, had never been taken seriously. “The most important thing is to improve the macroeconomic dialogue, and make it a policy instrument. It has to be clear that flexibility of labour markets is not the solution, but actually the other way round,” he said. “Each country has to live up to its means, which is nominal wages at the national level have to rise in line with national productivity in all member countries plus the commonly agreed inflation target of 2%.”

But Flassbeck warned that this was blocked in Brussels for ideological reasons. “I said it at the very beginning, in January 1999, but everybody opposed it. Otmar Issing from the ECB, a German, said ‘over my dead body’. But you have to talk about wages. The same with fiscal stimulus: countries should be able to use it. The German government should fully exploit the 3% that is available.”
Flassbeck was scathing about the way wages were pushed down in Germany. “This has dramatically failed and has not reduced unemployment,” he said, noting that the current account surplus has continued to grow because, “Germany has no economic model other than to export. This is destroying monetary union because others have to be debtors. We make them debtors and then tell them not to be debtors. This is impossible.”

But he appealed to the union movement to balance this tension. “You have to say that if wages fall, then other jobs will be in danger. And if wage increases are reasonable, they actually create jobs. It is a pre-condition for creating future jobs.”

More broadly, Flassbeck called for a change in how to control and monitor monetary union. “The core of the trouble is that too many people believe you can run it with the neo-classical ideas of flexibility of the labour market,” he said. “It was a great error to think you can run it with just monetary policy. You cannot have national experiments in wage cutting in a monetary union. It does not work. It worked for a while with Germany because it could beggar its neighbours. But after a while, the neighbour will became bankrupt or dead, and you cannot ask it to pay back its debt.”

The euro also needs equal treatment of all members by the ECB. “They should have the same interest rates across the Eurozone, as long as they abide by the rules,” he said. “I always fought for monetary union, but it was very badly managed. And this is the task of the Commission, and if the Commission cannot be the leading force, then we are in trouble.”

**Tobin: The labour consequences of austerity**

Austerity has been devastating, but the challenge now is to overcome its effects with the limited tools available, said Steven Tobin, Senior Economist in the International Labour Organisation’s Research Department.
Tobin outlined how the massive austerity in terms of wage reduction did not work because it choked off demand. “The reduction in demand only dampened further investment activity,” he said. “But more importantly, this kind of strategy can only work if you have something to compete against, but the reality in Greece is that exports were limited or non-existent at the time. So you reduce wages to compete on exports of what, exactly?”

Tobin said there was one takeaway from the labour markets that was most telling - long-term unemployment. “Today, 12 million people in Europe have been looking for job for more than year,” he said. “That is about half of all those looking for a job. This is approaching 80% in Greece. So close to one million of the 1.2 million people looking for a job in Greece have been looking for a job for more than a year. These people will not return to the labour market unless there is some sort of stimulus activity.”

For those 12 million Europeans looking for a job, Tobin noted that “the longer they stay out of the labour market, the more their skills erode, the more they become detached from any sort of job market, and the higher the risk to ever bring them back.”

**A job-friendly approach is key**

Tobin then explored what could be done to encourage job creation with “the limited means the European Commission has given us”. He said the Investment Plan for Europe unveiled by Commission President Jean-Claude Juncker last November was a welcome initiative that put job creation at its heart. “It aims to boost much-needed job creation, putting jobs on par with growth and investment objectives. And it provides a means to emphasise productive investment rather than short-term financial gains,” he said.

But Tobin cautioned about its potential. Running through various scenarios, he estimated the impact of the plan, which ran to about two million new jobs. “The Investment Plan can help, but it is not enough,” he said. He also compared the EU plan to the US Recovery and Reinvestment Act, noting that Europe was significantly less ambitious, setting aside 2.4% of GDP compared to 7.2% for the American plan.

Moving forward, Tobin suggested leveraging the plan to stimulate productive investment where it is most needed, arguing that wage growth would follow. He advocated active labour market policies for vulnerable groups as the cost of inaction was high. Social partners should be engaged in the design of training, he added. And finally, he said an impact evaluation of employment effects was crucial.

Tobin, who is also the lead author of the ILO studies on Greece and on the Juncker plan, noted that much of the investment before the crisis was not in productive sectors. “We have to recognise a shortfall of productive investment even before the crisis. But we are far, far away from having any sort of productive investment strategy in Europe. That is something we need
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Tobin concluded by appealing for unity across Europe in addressing labour and investment issues, rather than seeing them as only applying to certain member states. “The idea that it doesn’t matter if the hole is only at one end of the boat is a fallacy, because Europe at the moment is one big boat,” he said.

Coriat: Invest in social-ecological transition

A sustainable, environmentally-friendly European economy can only be achieved through investment in a social-ecological transition, according to Benjamin Coriat, an economics professor at Université Paris 13.

Coriat addressed the EU’s environmental challenges from a social perspective. He said the economic crisis was not only a disaster for the working classes but also threatened the environment. “What worries me is that the threats of climate change could lead to new neo-liberal advances,” he said, as he warned that new, risky financial instruments were being set up to deal with climate change. “Letting the market deal with climate change has led to the situation where a tonne of carbon now costs the same as a packet of cigarettes. By contrast, speculation and corruption in the carbon market has enriched many people.”

When it comes to climate change, Coriat said the poor often ended up paying the most for it. “In Greece, heating with fuel costs €1000, but with wood it is just €250, so obviously many people have slipped back to using wood. That has led to deforestation, a rise in pollution by 17%, and admonitions from the European Commission,” he noted.

Changing the models

Coriat suggested three responses to the crisis. First, he called for a break with the consumerist direction Europe is headed. He gave the example of the
French steelmaking plant of Florange, which became part of the ArcelorMittal steel empire in 2006 before closing in 2012, even though it was set to become far cleaner – a closure that Coriat interpreted as the French government meekly bowing down before business. “But it is madness to think that you can continue with diesel engines and emitting particulates into the lungs of newborn babies,” he said.

Secondly, he called for new productive models. “We don’t lack local initiatives – they are flourishing. What are lacking are national initiatives. They have to be based on shared use rather than private property,” he said.

And third, he said there was an opportunity to reinvigorate democracy. “Every global good – including the climate, the atmosphere - has a local dimension,” he said. “So if the global goods are not also managed locally, there is no way to manage them globally. We have to reactivate the idea of community, for example of shared wind farms.”

With all these demands, there was the obvious question about how to pay for it all. “This is the easiest thing,” he said. “The moment we have the will to escape these threats from the markets and finance, then paying is easy.”

He suggested re-establishing progressive taxes, noting that in the US, many millionaires signed a petition demanding to pay more tax. He also called for more taxes on financial markets. “People say there is no money. But of course there is money. Immense money in speculative markets,” he said. And he said carbon taxes are another source. “We cannot change society if we cannot pay for our externalities. We have to pay for our external costs,” he said.

Coriat also argued for new transfer policies to help balance rich and poor regions. “We can’t have these differences and pretend they don’t exist. We had them with the Structural Funds, which were helpful. We need them again,” he said.

Finally, he called for more investment in environmental innovation, noting that France invests €7billion in the sector. “These forms of investment and financing could help European integration,” he said citing solar energy in the south and marine wind farms in the north. “They could bring the south to the north.”
Ségol: We have a huge job ahead

The arguments against austerity are compelling, but opponents still have a huge task ahead, according to Bernadette Ségol, the General Secretary of the European Trade Union Confederation.

Delivering the concluding speech of the event, Ségol said unions had to keep their feet on the ground. “We need to ask what we can do,” she said. “I am impressed – if sorry – that these powerful arguments that we have had for years have not yet made their way to the powers that be in the Eurozone. We have a huge job to do to convince EU leaders of our arguments. Why have we not been able to carry this message, even though we have the leaders to do this?”

She agreed that the question of wages was a key one, but warned that unions lacked the means to tackle it. “Imagine what it is to be a negotiator in a small company somewhere in France, Italy or even Germany, where you have the choice of getting 200, 1000 or even 10 people out of a job, or an increase in wages,” she said, adding that it was particularly galling for workers on minimum wages to hear about businesses avoiding taxes.

Ségol talked of how “bloody hard” it had been when she was leading the macro-economic dialogue. “When I was facing Olli Rehn and Mario Draghi, their only comparison was unit labour costs. So we are facing a wall. That is the reality as European trade unions.”

Fight Europe’s despair

But Ségol did have some solutions. “We can aim at a minimum wage set at a percentage of average wages,” she said. “It is difficult, even among unions, but we can do it. We have an obligation to propose targets that can be met. We proposed an investment plan that was much more ambitious than that proposed by Juncker and would have been over 10 years. If we want to stop the race to the bottom we need European initiatives on posting of workers and other issues.”
Ségol agreed that the environment was a priority, even if it cost more to take it into account. “It is a common good, and we have an obligation to keep the pressure up to ensure that the public service workers are protected if their jobs are at risk,” she said.

At a broader level, she said unions had to make their concerns known. “We have an enormous amount to do to show that we are all in the same boat,” she said. “At the moment, I’m not sure the average citizen feels that. I’m not sure that the average Finn, German, or Pole feels the same as the average Greek, Spaniard or Irish.”

But Ségol said the consequences of inaction were too serious to ignore. “We have to fight European despair. Because the beneficiary of despair is not Alexis Tsipras but Marine Le Pen. We have to show that this despair is not for today or tomorrow. We have to show that the policies of the far right are not those that will create jobs,” she said. “We have many challenges facing us. But I sincerely feel that the union movement continues to have an ability to change things and to persuade. Because if we are silenced, it would be a great loss for Europe and democracy.”